Supreme Court, U. S.
FILED
AUG 14 1976
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-222

ESTATE OF ALVIN THALHEIMER, RUTH B. ROSENBERG, SURVIVING EXECUTRIX, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent,*

No.

ESTATE OF HENRIETTA G. BLAUSTEIN, HILDA K. BLAUSTEIN and RUTH B. ROSENBERG, SURVIVING EXECUTRICES, *Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

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Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit finally entered in this proceeding on May 24, 1976.

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court are reported at 33 T.C.M. 877 (August 5, 1974) and are reprinted in Appendix A hereto,[1] at pp. 1a-70a. The decisions of the Tax Court stating its deficiency determinations were entered December 18, 1974, and are reprinted at App. B., pp. 71a-73a. The opinion of the Court of Appeals, which is not yet officially reported, is reprinted at App. C., pp. 74a-75a. The order of the Court of Appeals, denying a petition for rehearing, was issued May 24, 1976 and filed May 26, 1976, and is reprinted at App. D., p. 76a.

JURISDICTION

The initial judgment of the Court of Appeals was entered on April 13, 1976. A timely petition for rehearing was filed on April 27, 1976, and was denied on May 24, 1976. This petition for certiorari is filed within 90 days of the latter date. Jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED

The amount of Federal Estate Tax payable by a decedent's estate varies directly with the fair market value[2] of the estate's assets, *i.e.*, the amount which could be realized from a sale. In the present cases, each of the estates consisted largely of stock in a closely-held corporation, which itself held large blocks of stock in

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[1] The separate Appendix to this petition is hereafter cited as "App.".

[2] The regulations provide that "the value of every item of property . . . is its fair market value . . . [which] is the price at which the property would change hands between a willing buyer and a willing seller. . . ." Treas. Regs. Sec. 20.2031-1(b).

publicly traded corporations. The parties and both courts below agreed that a determination of the value of the closely-held corporation stock owned by the decedents would depend in large part on the value to the closely-held corporation of the blocks of stock owned by it and that therefore it was necessary to determine the fair market value of such blocks.

The questions presented are whether in making these determinations:

1. As a matter of law, must factors, such as blockage, restrictions on resale and potential capital gains taxes, all of which would both reduce the net amount actually realizable from a sale and would necessarily be taken into account by a potential buyer of the closely-held corporation stock, be disregarded solely because the closely-held corporation did not contemplate making an immediate sale of the blocks owned by it.

2. As a matter of law, may the prices at which the listed stock of one of the corporations was traded on the stock exchange be completely ignored in determining fair market value.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved in this case are Section 2031 of the Internal Revenue Code of 1954 (26 U.S.C. Sec. 2031) and Sections 20.2031-1(b) and 20.2031-2(a), (b), (c), (e), and (f), of the Treasury Regulations on Estate Tax (26 C.F.R. Secs. 20.2031-1(b) and 20.2031-2(a), (b), (c), (e), and (f)). These provisions are set forth at App. E, pp. 77a-80a.

STATEMENT OF THE CASE

These two consolidated cases involve alleged Federal estate tax deficiencies of more than $1 million. The Court of Appeals affirmed *per curiam* the Tax Court's deficiency determinations.[3]

The sole issue presented to the Tax Court in each case was the value of decedents' stockholdings in a closely-held corporation, American Trading and Production Company (hereafter "Atapco"). The parties and the Courts below agreed that this issue required a determination of Atapco's net asset value (*i.e.,* the fair market value of its assets less liabilities) which, in turn, required a determination of the fair market value of Atapco's very large stockholdings in publicly traded companies.[4]

At the time of decedents' deaths, Atapco held large blocks of stock of several public companies, including Standard Oil of Indiana ("Indiana"); Standard Oil of New Jersey ("Jersey"); Crown Central Petroleum Corporation ("Crown"); United States Fidelity and Guaranty Corporation ("U.S.F.&G."); and Union Trust Company of Maryland ("Union Trust"). (R.12-19.)[5]

[3] The Tax Court determined the following deficiencies: *Estate of Alvin Thalheimer* (date of death, July 8, 1965), $676,349.71; *Estate of Henrietta G. Blaustein* (date of death, December 8, 1965), $481,228.02. (App. B. pp. 71a-73a.) The Court of Appeals affirmed but ordered a remand to correct an error favoring the Government (to which a relatively small amount of tax was attributable).

[4] The parties stipulated the net asset values of Atapco's several operating divisions. The issue of how much the value of decedents' Atapco stock was less than an aliquot portion of Atapco's net asset value is not presented in this petition for certiorari.

[5] "R." designates references to the Joint Appendix filed in the Court of Appeals.

All of these stockholdings were affected by factors which would limit the net amount which Atapco could realize from a sale to a willing buyer, the only proper criterion for determining the value of such holdings for tax purposes. Atapco's Indiana, Crown and Union Trust holdings were particularly large.[6] The petitioners' expert witness, Mr. Alvin Friedman of Kuhn, Loeb & Co., presented undisputed testimony in the Tax Court that those holdings were subject to blockage and could not have been sold in a reasonable period of time without reducing the selling price per share substantially below the prevailing market prices for small lots of Indiana, Crown and Union Trust stock. Mr. Friedman also presented undisputed testimony that the sale of Atapco's holdings in Indiana, Crown and Union Trust was subject to serious restrictions under the Federal Securities laws. (R. 55-57, 545e-548e.)

In addition to the restrictions affecting Atapco's freedom to sell its Indiana, Crown and Union Trust holdings, Atapco had an extremely low basis in almost all of its stockholdings and could not have sold its holdings without incurring substantial capital gains tax, which would further have reduced the amounts realizable from the sales by Atapco. (R. 56-57; 545e-549e.)

Mr. Friedman further testified that a buyer of Atapco shares would take into account the restrictions and conditions which would depress the value of Atapco's main assets and would also take into account the capi-

[6] Atapco was the largest single Indiana shareholder in 1965, with 2.94% of the total 70,794,742 shares outstanding. Atapco held 48.8% of outstanding Crown stock in 1965. Atapco owned 28,710 shares of Union Trust which was approximately 5% of the total shares outstanding.

tal gains tax which would reduce the amounts realizable from a sale by Atapco. (R. 56-57;71; 545e-549e.)

The Government presented no evidence in the Tax Court to refute Mr. Friedman's conclusions that blockage, Federal Securities law restrictions and capital gains taxes would reduce the amount Atapco could realize from a sale of its stockholdings and that a potential buyer of Atapco stock would take these adverse factors into account in negotiating a price. However, the Government's witness, Mr. O'Farrell (an I.R.S. employee), asserted that factors depressing the net amounts realizable on a sale of Atapco's stockholdings should not be considered in determining Atapco's net asset value, because Atapco was a "going concern" not contemplating an immediate sale of its assets. Without ever testifying as to what effect such depressing factors would have had on the price which a willing buyer would have been prepared to pay for Atapco's stock, Mr. O'Farrell simply proceeded to value Atapco's holdings in public companies (except Crown) at the prices prevailing in the market for unrestricted small lots of stock in those companies, without adjustment to reflect the factors, expenses and tax costs which would reduce the value of Atapco's large holdings. (R. 617e-643e.)

In the case of Atapco's Crown stockholdings, Mr. O'Farrell not only failed to adjust stock market prices downward to reflect the factors which would reduce what Atapco could realize, but he completely disregarded the quoted prices of Crown stock on the American Stock Exchange. He valued Atapco's large, restricted block of Crown stock at book value, more than twice the quoted market price for unrestricted shares, asserting that the market for Crown stock was "thin." (R. 101-102, 617e-643e.) However, the stipulated, undisputed evidence showed that trading in Crown stock was as heavy at the valuation dates as trading in Jersey or Indiana stock, for which Mr. O'Farrell used quoted market prices without any concern for a "thin" market. (R. 12, 15-16, 190e-191e, 235e-240e, 277e-278e; Pet. Br. 37-39.)[7]

The basic issue presented to the Tax Court was whether under proper standards for valuation the undisputed blockage, restrictions on sales and tax costs, all of which would have substantially reduced the amount Atapco could have realized from a sale of its stockholdings, should be considered in determining Atapco's net asset value and, therefore, in determining the fair market value of the Atapco stock owned by the decedents. A subsidiary issue was whether Crown stock could be valued without any regard to its quoted stock exchange prices.

The Tax Court held as a matter of law that, solely because no sale was imminent, the factors which would reduce the amount Atapco could realize from a sale could not be considered in determining the net asset value of Atapco stock.[8] In addition, the Tax Court held that stock of Crown should be valued in Atapco's hands at book value, which was more than twice the price for that stock established in market trades on the valuation dates.

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[7] "Pet. Br." refers to the petitioners' brief filed in the Court of Appeals.

[8] However, the unlikelihood of imminent sales did not prevent the Tax Court from accepting Mr. O'Farrell's use of market prices for sales of small unrestricted lots to value Atapco's large, restricted stockholdings.

The Court of Appeals for the Fourth Circuit affirmed the Tax Court's decision *per curiam* and thus sanctioned the above conclusions of law by the Tax Court, notwithstanding that Chief Judge Haynsworth had noted during the oral argument that, since the value of property is defined as "market value," a definition which requires the assumption of a hypothetical sale, he had "grave problems" with the Government's position that factors relevant to sale value can be disregarded in estate tax valuation merely because no actual sale of property appears imminent. The Court of Appeals also sanctioned the Tax Court's valuation of Crown stock without any regard to quoted market prices.

REASONS FOR GRANTING WRIT

Summary

The Court of Appeals' decision conflicts squarely with decisions of the Court of Appeals for the Third Circuit. *Laird* v. *Commissioner,* 85 F.2d 598 (3d Cir. 1936); *Amerada Hess Corporation* v. *Commissioner,* 517 F.2d 75 (3d Cir. 1975), *cert. denied,* 423 U.S. 869, 96 S. Ct. 574 (1975); *Hazeltine Corporation* v. *Commissioner,* 89 F.2d 513 (3d Cir. 1937).

The decision of the Fourth Circuit and the conflicting decisions of the Third Circuit involve an important area of law as to which this Court has not directly addressed itself and which should be settled by this Court.

The decision of the Fourth Circuit is also in conflict with the principles enunciated by this Court in *Ivan Allen Co.* v. *United States,* 422 U.S. 617 (1975), that for tax purposes securities owned by corporations should be valued at the net amounts realizable from

their sale rather than on other bases having no economic reality.

I.

THE DECISION OF THE COURT OF APPEALS FOR THE FOURTH CIRCUIT DIRECTLY CONFLICTS WITH DECISIONS OF THE COURT OF APPEALS FOR THE THIRD CIRCUIT.

A. Refusal to Consider Factors Depressing Hypothetical Sale Value

The Tax Court held as a matter of law that, regardless of the effect in the market of blockage, restrictions on sale, tax costs and other factors affecting the hypothetical sale value of Atapco's assets, these elements could not be considered in valuing Atapco stock because an immediate sale of the assets was not contemplated. (App. A, p. 67a.) The Court of Appeals' *per curiam* affirmance sanctioning this decision conflicts directly with the decision of the Court of Appeals for the Third Circuit. In *Laird* v. *Commissioner,* 85 F.2d 598 (3d Cir. 1936), the Third Circuit Court reversed the Board of Tax Appeals for its failure to consider the effect of blockage and other restrictive factors on the market value of stocks held by close corporations, in determining the value of the latter corporations. No sales of the stocks by the close corporations was there contemplated. Nonetheless, the Third Circuit Court stated that the Board's method, which failed to take account of factors that would affect a hypothetical sale by the holding corporations—

> "[*N*]*ot only ignored the treasury regulations prescribing the method by which stock in close corporations should be valued, but directly violated these regulations.* Stock in such a [close] corporation must not be valued 'by taking the mean

between the highest and lowest quoted selling prices' of the stock constituting the assets of the corporation to determine the worth of the company. . . . *The stock in these two close corporations could not have been sold on the day of Mr. Laird's death, for no one could have forced the sale of all the stock constituting the assets of the [corporations]. . . . Even if it could have been done, . . . the testimony was that it would have driven the price of the du Pont stock [held by the corporations] down from $325 to $125 per share.* That of course was a guess, but it shows that the method which the Board used was impractical when applied to the determination of the value of the assets of close corporations which consist entirely of stock listed on stock exchanges. . . ." 85 F.2d at 601 (emphasis supplied).

Other courts have followed the Third Circuit Court's approach and have considered the effect on asset value of factors such as blockage and capital gains taxes in valuing closely-held corporations, even though there was no indication that the corporate assets were about to be sold. *E.g., Obermer* v. *United States*, 238 F. Supp. 29 (D. Hawaii 1964); *Bishop Trust Company* v. *United States*, 42 A.F.T.R. 1221 (D. Hawaii 1950). The Tax Court itself, in a more recent case, took account of the effect of trapped capital gains tax in valuing the stock of a holding company. *Estate of Maurice Gustave Hecksher*, 63 T.C. 485, 495 (1975).

The Third Circuit Court's *Laird* decision and the cases following the *Laird* approach properly interpret Treasury Regulations Section 20.2031-2(f)(2),[9] which

[9] *Laird* interpreted Treasury Regulations 70, Art. XII under Section 302 of the Revenue Act of 1926. Those Regulations were substantially identical to the successor, present Treasury Regulations Section 20.2031-2(f)(2) and 20.2031-1(b) under Section 2031 of the Internal Revenue Code of 1954.

requires that the net worth, or net asset value, of every closely-held company be determined for valuation purposes, regardless of whether the corporation is a going concern. Net asset value is by definition a measure in which "the *hypothesis* of a sale forms the basis of value." Bills, *Reduction in Value of Closely Held Stocks Due to Income Tax Liabilities*, 44 Taxes 487, 489 (1966) (emphasis supplied).

The requirement of Regulations Section 20.2031-2(f)(2), that the net asset value of a corporation be determined on the basis of a hypothetical sale of its assets, is a specific application of the basic principle of the Regulations that—

> "The value of every item of property includable in a decedent's gross estate . . . is its fair market value. . . . [F]air market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." Treas. Regs. Sec. 20.2031-1(b).

Any potential purchaser of the stock of a corporation whose primary value resides in its holdings of stock of other companies would consider, among other factors, the net value available to the corporation from a sale of its holdings for its corporate purposes. Thus, the SEC rules for publicly traded investment companies require all factors affecting the hypothetical sale value of an investment company's stockholdings to be disclosed. Specifically, the SEC requires the disclosure of trapped capital gains (17 C.F.R. Secs. 210.6-02(f)(2), 210.6-02(i); 17 C.F.R. Sec. 210.6-03-23 and 17 C.F.R. Sec. 270.2a-4); and has held that it is improper to value restricted stock at the market price

for unrestricted stock. Accounting Series Release No. 113, Investment Company Act Release No. 5847 (October 21, 1969). *See* Accounting Series Release No. 116, Investment Company Act Release No. 6026 (April 13, 1970). The SEC has plainly determined that these factors would be considered by willing buyers and sellers of stock in arriving at the market value of the holding corporation's stock. Yet the Tax Court and the Court of Appeals held as a matter of law, in direct conflict with the Third Circuit Court, that these factors cannot be considered in determining the price that Atapco stock would bring in a sale between a willing and informed buyer and seller. It is the Third Circuit's view, however, which is correct as a matter of law.

The Court of Appeals in the instant case offered no reason for its departure from the rule of the Third Circuit Court. The only reason offered by the Tax Court was that Atapco "is a diverse, viable going concern and there is no evidence of a plan for its liquidation, voluntary or otherwise." 33 T.C.M. at 911, App. A p. 67a. There is neither authority nor reason for valuing a particular asset at varying amounts depending on whether or not an imminent sale is contemplated. Both Courts simply disregarded the *Laird* case, cases following *Laird*, the Regulations, and applicable SEC criteria in refusing to consider factors which have long been recognized as relevant to determinations of market value, *i.e.*, what a willing buyer would pay.

B. Failure To Utilize Market Quotations in Valuing Crown Stock

The Court below affirmed the Tax Court's valuation of Atapco's Crown stock at book value without regard to the market prices at which Crown stock was actually

traded on the American Stock Exchange. This affirmance violated the clear mandate of the Regulations that—

> "[I]f there is a market for stocks or bonds, on a stock exchange, in an over-the-counter market, or otherwise, the mean between the highest and lowest quoted selling prices on the valuation date is the fair market value per share or bond." Treas. Regs. Sec. 20.2031-2(b)(1).

The decision of the Court below is in direct conflict with decisions of the Third Circuit Court. *Amerada Hess Corporation* v. *Commissioner,* 517 F.2d 75 (3d Cir. 1975), *cert. denied,* 423 U.S. 869, 96 S. Ct. 574 (1975); *Hazeltine Corporation* v. *Commissioner,* 89 F.2d 513 (3d Cir. 1937). In *Hazeltine, supra,* the Third Circuit Court reversed a "fair market value" determination by the Board of Tax Appeals which ignored the prices at which stock was actually sold on the New York Curb Exchange. The Court stated:

> "The Board seems to have ignored the evidence of fair market value furnished by the sales upon the Curb exchange and in this we think it fell into error. The primary evidence of the fair market value of corporate stock is what willing purchasers pay to willing sellers on the open market, even though the assets of the corporation do not reflect such values." 89 F.2d at 519 (3d Cir. 1937).

More recently, in *Amerada Hess Corporation, supra,* the Third Circuit Court reversed the Tax Court's determination that the value of a large block of stock was the amount set by the parties to a corporate exchange of the stock for assets for the purpose of determining the number of shares to be issued, rather than the actual market value at the time the exchange was made, less a discount for blockage. The Tax Court

had concluded that the large block involved made market prices unreliable. Nevertheless, the Third Circuit Court held:

> "Where . . . the property to be valued consists of securities traded on a stock exchange, the general rule is that the average exchange price quoted on the valuation date furnishes the most accurate, as well as the most readily ascertainable, measure of fair market value . . . Market analysts have developed reliable techniques for determining the amount by which the market price should be adjusted to correct for various abnormalities. . . . The Tax Court, however, neither adopted nor adapted the market price as the proper index of valuation in this case." 517 F.2d at 84.

The Court below, in affirming the Tax Court, placed itself squarely in opposition to the Third Circuit. Instead of directing the Tax Court to "adopt or adapt" market prices, as the *Amerada Hess* case requires, the Court below sanctioned the Tax Court's complete abandonment of market prices in favor of book value. Book value was more than twice the market price for the Crown stock. The only reason given by the Government's witness for using book value rather than market price was that the market for the Crown stock was "thin."[10] Even if the Crown market were determined to be "thin," and therefore market values should not be a wholly determinative starting point for valuation, the asserted "thinness" would not warrant the arbitrary use of book value instead of applying the valuation standards developed in the regulations ap-

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[10] Government counsel, with commendable frankness, made on oral argument in the Court below the more persuasive statement that book value was employed in the Crown situation since it produced a higher valuation than did market value.

plicable to the case of stock for which the market does not accurately reflect the fair market value. Treas. Regs. Sec. 20.2031-2(e). See Treas. Regs. Sec. 20.2031-2(f)(2).

II.

THE PROPER DISPOSITION OF THIS CASE INVOLVES AN IMPORTANT QUESTION OF LAW WHICH SHOULD BE SETTLED BY THIS COURT.

It is commonly said that valuation is not an exact science. Precisely because of the broad possibilities for inconsistency which exist in this area, it is imperative that the basic criteria, which form the only bounds on the Tax Court's otherwise complete discretion, be clearly identified, authoritatively established, and applied consistently. This Court has recognized that the criteria to be applied in valuation cases are a matter of law and has heretofore reversed decisions applying improper standards. *See Powers* v. *Commissioner*, 312 U.S. 259 (1941).

It is a matter of common knowledge that many closely-held corporations themselves hold stock in other corporations and that it is frequently necessary to value these holdings in other corporations in connection with arriving at the value of the closely-held stock. Within six months after the Tax Court rendered its decision in the present case, it rendered decisions in two other cases—*Estate of Maurice Gustave Hecksher, supra,* and *Edwin A. Gallun,* 33 T.C.M. 1316 (1974)—which involved such a valuation question. In *Hecksher,* the Tax Court took into account the effect of the capital gains tax which would have been incurred on a sale of the securities. In *Gallun,* it took into account the effect of blockage which would have reduced the price obtainable on a sale, but refused to

give any effect to the capital gains tax which would have been incurred.

The erratic application of valuation standards exemplified by these two cases, and by the conflict between the Third and Fourth Circuits, demonstrates the need for this Court to settle authoritatively the principle to be followed so that there can be a modicum of uniformity and certainty in this area. If these two decedents had lived in Philadelphia instead of Baltimore, the estate tax liability would have been determined under the principles enunciated by the Third Circuit in *Laird* and would have been very much less than the tax determined by the Tax Court and affirmed by the Fourth Circuit. This would have also been true if they lived in Honolulu, where the courts have followed *Laird*. *See Obermer* v. *United States, supra,* and *Bishop Trust Company* v. *United States, supra.*

III.

THE COURT BELOW DECIDED THE BASIC ISSUE PRESENTED IN A WAY WHICH IS CONTRARY TO THE PRINCIPLES ESTABLISHED BY THIS COURT IN ANOTHER CONTEXT.

It is necessary to determine values of stocks of other corporations held by a particular corporation not only for the purposes of determining estate and gift taxes, but also for other purposes, such as determining the amounts which are available to meet business needs of the owning corporation for accumulated earnings tax purposes.[11] In *Ivan Allen Company* v. *United States,* 422 U.S. 617 (1975), this Court determined that appreciated stocks owned by the taxpayer should be valued at their fair market value less the costs of converting

[11] The accumulated earnings tax is imposed under Sections 531-37 of the Internal Revenue Code of 1954 (26 U.S.C. Secs. 531-37).

them into cash and the capital gains taxes which would be payable, rather than at book value. This Court stated that "the proper measure of those securities, for the purposes of the [Sec. 531] tax, is their *net realizable value.*" 422 U.S. at 629 (emphasis supplied).

It is submitted that the decisions by the Court of Appeals for the Third Circuit in *Laird, Amerada Hess* and *Hazeltine, supra,* are consistent with the holding of this Court in *Ivan Allen, supra,* and that when the Tax Court ignored these cases and the Court of Appeals for the Fourth Circuit affirmed the Tax Court, the present cases were decided in a manner contrary to the valuation standards enunciated by this Court.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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